

## TEACHERS' RETIREMENT BOARD

### REGULAR MEETING

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SUBJECT: Adoption of Investment Options for the Voluntary  
Investment Program

ITEM NUMBER: 7

ATTACHMENT(S): 1

ACTION: X

MEETING DATE: July 11, 2002

INFORMATION:     

PRESENTER: Ed Derman and Christopher J. Ailman

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The California State Teachers' Retirement System (CalSTRS) offers the Voluntary Investment Program (VIP), a 403(b) program that enables CalSTRS members and participants to supplement their retirement assets on a tax-deferred basis. Section 24950 of the Education Code requires CalSTRS investment staff to make recommendations to the Board on the appropriate investment options made available to VIP participants, and the Board has the sole responsibility for selecting the service providers. At the February meeting, the Board awarded the contract to provide recordkeeping services for the Voluntary Investment Program (VIP) to CitiStreet, LLC, a joint venture of CitiBank and State Street Bank. As part of the new recordkeeping contract, VIP participants will be able to receive investment advice through the use of Financial Engines, both online and through CitiStreet financial counselors. Under the advice program, the Financial Engines model will make recommendations on the level and allocation of VIP investments to enable the VIP participant to increase the probability of achieving his or her retirement goal, given all the participant's investments, both taxable and tax-deferred, risk levels, and spending expectations.

### **SELECTING INVESTMENT OPTIONS**

In order to permit the VIP participant to implement the recommendations of Financial Engines effectively, the investment options made available to VIP participants need to be expanded. Currently, VIP offers only three core investment options—a money market fund, an international fund that replicates the Europe, Australia, and Far East (EAFE) Index, and an index fund that replicates the Standard and Poor (S&P) 500 Index. This does not provide sufficient diversity to properly implement an asset allocation recommendation made by Financial Engines.

CalSTRS staff developed a plan to broaden the investment options available to VIP participants to include all the significant broad asset classes. Specifically, CalSTRS staff initiated an evaluation of funds in 11 separate asset classes. Providing 11 different investment options is consistent with the number of options offered in 401(k) plans, the most common defined compensation retirement plan. According to a survey of 428 401(k) plans by Hewitt Associates in 2000, the average 401(k) fund has 12 investment options. Hewitt also reported that 60 percent of the plans had at least 10 investment options. The 11 asset classes evaluated by CalSTRS staff were:

- Passive S&P 500 Index
- Passive broad market
- Active large cap growth
- Active large cap value
- Active mid cap growth
- Active mid cap value
- Active small cap growth
- Active small cap value
- Active international equity
- Intermediate bond
- Money market

This core fund selection would be in addition to the existing opportunity for VIP participants to invest in a self-managed account, which includes about 3,000 mutual funds, at least 600 of which do not impose any load or transaction fees. The Financial Engines model will not make recommendations on the allocation of assets selected through the self-managed account.

In evaluating potential fund selections in each asset class, Investment Branch staff used fund-screening software to evaluate various characteristics of the funds, including historical performance, investment management fees, and measures of volatility. From that screening, staff identified the three best funds, and requested CitiStreet to identify the investment fee and other cost information, plus any other funds in those classes that CitiStreet believed may be superior to CalSTRS preliminary identification. After incorporating the data provided by CitiStreet into its own analysis, the staff determined which funds would be the best overall option for VIP participants. In each case, either the fund does not charge a load, or the load normally charged is being waived. In addition, under the shareholder services agreements with CitiStreet, some funds share a portion of the revenue collected from investment management fees with CitiStreet, which gets passed on to CalSTRS. These revenues can be used either to reduce program costs to VIP participants or finance initial costs of supplemental investment program expansions.

The 11 funds recommended by the staff are:

<b>Asset class</b>	<b>Fund name</b>	<b>Expense ratio (basis points)</b>	<b>Revenue sharing (basis points)</b>	<b>Average expense ratio for asset class</b>
Passive S&P 500	Vanguard Institutional Index	6	0	63
Passive broad market	Vanguard Total Stock Index Institutional	8	0	81
Active small cap value	State Street Research Aurora A	143	35	147
Active small cap growth	Brown Capital Small Company Institutional	135	10 to 35 <sup>1</sup>	169
Active mid cap value	Prudential Jennison Equal Opportunity A	113	40	161
Active mid cap growth	Delaware Trend Institutional	105	\$6 per participant	166
Active large cap value	Dodge & Cox Stock	54	10	145
Active large cap growth	Fidelity Growth	85	25	158
Active international equity	Artisan International	122	35	168
Intermediate bond	Vanguard Total Bond Index Institutional	10	0	107
Money market	Citi Institutional Liquid Reserves	20	0	53

<sup>1</sup>Revenue sharing increases with asset base

## **RECOMMENDATION**

The funds identified by CalSTRS staff provide the best combination of risk, performance, cost and diversity for VIP participants. Pursuant to Section 24950, CalSTRS Investment Branch staff recommends the Board select the following funds as investment options in the CalSTRS VIP:

Vanguard Institutional Index  
Vanguard Total Stock Index Institutional  
State Street Research Aurora A  
Brown Capital Small Company Institutional  
Prudential Jennison Equal Opportunity A  
Delaware Trend Institutional  
Dodge & Cox Stock  
Fidelity Growth  
Artisan International  
Vanguard Total Bond Index Institutional  
Citi Institutional Liquid Reserves

PROPOSED  
RESOLUTION  
OF THE  
TEACHERS' RETIREMENT BOARD

SUBJECT: Adoption of Investment Options for the Voluntary Investment Program

RESOLUTION NO. \_\_\_\_\_

WHEREAS, the Teachers' Retirement Law authorizes the Teachers' Retirement Board to offer an annuity contract and custodial account as described in Section 403(b) of the Internal Revenue Code to school employees, and

WHEREAS, the Teachers' Retirement Board offers the Voluntary Investment Program to school employees pursuant to that authorization, and

WHEREAS, the Teachers' Retirement Law also requires the investment staff of the California State Teachers' Retirement System to make recommendations to the Teachers' Retirement Board as to the appropriate investment options, and

WHEREAS, the investment staff of the California State Teachers' Retirement System has evaluated the most appropriate investment options among a comprehensive selection of asset classes based on a variety of criteria, including, historical performance, cost and volatility; therefore, be it

RESOLVED, that the Teachers' Retirement Board adopts the recommendations of the investment staff of the California State Teachers' Retirement System with respect to the investment options for the Voluntary Investment Program.

Adopted by:  
Teachers' Retirement Board

on July 11, 2002

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JACK EHNES  
Chief Executive Officer